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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1969

No. 412

FRED W. WOODWARD and ELSIE M. WOODWARD
F. R. WOODWARD and M. JEANNE WOODWARD
Petitioners

v.

COMMISSIONER OF INTERNAL REVENUE
Respondent

On Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit

BRIEF FOR THE PETITIONERS

OPINIONS BELOW

The opinion of the Tax Court of the United States is reported at 49 TC 377; viz., the majority opinion by Judge Norman O. Tietjens appears at A. 28,[1] the dissenting opinion of Judge J. Gregory Bruce appears at A. 37 and the dissenting opinion of Judge William M. Fay appears at A. 46.

[1] "A." refers to the tan-covered booklet entitled "APPENDIX".

The opinion of the Court of Appeals for the Eighth Circuit is reported at 410 F. 2d 313; viz., the majority opinion by Judge M. C. Matthes appears at A. 49.

JURISDICTION

The judgment of the Court of Appeals was entered on May 2, 1969 (A. 64). The petition for a writ of certiorari was filed on July 31, 1969, and was granted on October 20, 1969 (A. 65). The jurisdiction of this Court is invoked under 28 U. S. C. 1254 (1).

QUESTION PRESENTED

Are amounts paid by majority stockholders (Taxpayers) for attorneys', appraisers' and accountants' fees for services rendered in connection with a state court litigation, the primary purpose of which was the judicial determination of the real value of a dissenting shareholder's common stock, deductible, under the provisions of Section 212 of the Internal Revenue Code of 1954, as ordinary and necessary expenses paid or incurred for the management, conservation, or maintenance of property held for the production of income?

OR

in the alternative

Are fees and costs paid by majority shareholders (Taxpayers) relative to an equitable action arising under a state appraisal statute wherein the only issue was the "real value" of the common stock owned by a dissenting shareholder—title to such stock not being at issue or in dispute—capital expenditures incurred in connection with the acquisition of the title to the stock owned by the dissenting shareholder and therefor nondeductible under the provisions of Section 263 of the Internal Revenue Code of 1954?

STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of Section 212 of the Internal Revenue Code of 1954 follows, to-wit:

"Section 212. Expenses for Production of Income

In the case of an individual, there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year—

* * * * * * *

(2) for the management, conservation, or maintenance of property held for the production of income;"

The pertinent provisions of Section 263 of the Internal Revenue Code of 1954 follows; to-wit:

"Section 263. Capital Expenditures

(a) General Rule.—No deduction shall be allowed for—

(1) Any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate."

The pertinent provisions of the Treasury Regulations applicable to the foregoing code sections, appear in the App., infra,[2] p. A-6 re Section 1.212-1 and in the App., infra, p. A-9 re Section 1.263(a)-2.

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[2] "App., infra," refers to the "APPENDIX" contained herein.

STATEMENT OF THE CASE

The petitioners, Fred W. Woodward and Elsie M. Woodward, are husband and wife (A. 2). The petitioners, F. R. Woodward and M. Jeanne Woodward, are husband and wife (A. 2). All of the petitioners (hereinafter referred to jointly as "Taxpayers") are residents of Dubuque, Iowa (A. 2). Each couple filed a joint federal income tax return for calendar year 1963 with the District Director of Internal Revenue at Des Moines, Iowa (A. 2).

The jurisdiction of the Tax Court of the United States, the court of first instance, was invoked as a result of the filing by the taxpayers, within the time permitted by Section 6213 of the Internal Revenue Code of 1954, 26 U. S. C., Section 6213, of petitions for the redetermination of their 1963 federal income tax.

The Telegraph-Herald was originally organized as a profit corporation under the laws of the State of Iowa in 1901. Its corporate existence was renewed in 1921 and in 1941 (A. 18 and 30). The corporation is engaged in publishing a daily newspaper, operating a commercial printing plant and operating a radio station in Dubuque, Iowa (A. 2 and 19).

Pursuant to the 1941 renewal of its charter the corporate existence of the Telegraph-Herald was extended for a twenty year period to November 1, 1961 (A. 18 and 30). Section 491.25 of the 1958 Code of Iowa provides a statutory procedure for the renewal of a corporation existing for a term of years (A. 31).

On May 24, 1960, at the direction of the President of the corporation, written notice was given to each of the common stock shareholders of the Telegraph-Herald of a special meeting of such shareholders to be held at the office of the corporation in Dubuque, Iowa on June 9, 1960, for the purpose of renewing the corporation's existence

perpetually and placing certain restrictions upon the sale and transfer of its outstanding common stock (A. 9).

The issued and outstanding common capital stock of the Telegraph-Herald, at all times pertinent, consisted of 1,200 shares of $100 par value common stock. The ownership of the shares of common stock of the Telegraph-Herald as shown by the books and records of the corporation on June 9, 1960, was as follows (A. 3 and 19); to-wit:

Common Stockholder	Number of Shares
Fred W. Woodward	398
F. R. Woodward	58
M. Jeanne Woodward	55
Elsie M. Woodward, F. Robert Woodward, M. Jeanne Woodward and American Trust and Savings Bank of Dubuque, Iowa, as Trustees of Fred W. Woodward Trust No. 1	200
Elsie M. Woodward, F. Robert Woodward, M. Jeanne Woodward and American Trust and Savings Bank of Dubuque, Iowa, as Trustees of Fred W. Woodward Trust No. 2	100
Charles Murphy, Executor of the Estate of Ellen Murphy, Deceased	10
Margaret M. Quigley	379
Total number of shares of the common stock of the Telegraph-Herald issued and outstanding on June 9, 1960	1,200

At the special meeting of the common stock shareholders of the corporation held on June 9, 1960, at which all 1,200 shares of the outstanding $100 par value common stock were represented, a resolution proposing perpetual existence and renewal was submitted for adoption (A. 11).

The proposed resolution was approved and adopted at said meeting by all common stock shareholders except Margaret M. Quigley, who voted all of her 379 shares of stock against the adoption of the resolution (A. 14).

Margaret M. Quigley acquired her 379 shares of stock of Telegraph-Herald by bequest from her husband, Joseph C. Quigley, who died January 22, 1952 (A. 20).

The common capital stock of the Telegraph-Herald has not been sold or offered for sale nor have any bids been made to purchase said stock during the years 1950 to June 9, 1960 (A. 20).

A certificate for the renewal of the Telegraph-Herald's corporate charter was issued by the Secretary of State for the State of Iowa, on or about June 10, 1960 (A. 4).

The Taxpayers having voted with the majority of the Stockholders for the renewal of the corporate charter of the Telegraph-Herald on June 9, 1960, were obligated and required by the terms and conditions of Section 491.25 of the 1958 Cole of Iowa to purchase the dissenting shareholder's 379 shares of the common stock of the Telegraph-Herald at its "real value" (A. 4). This duty of the majority stockholders to purchase the stock of the dissenting stockholder arose as of the date the vote for renewal was taken, June 9, 1960 (A. 21 and 23). The statute imposes no duty on the corporation, as such, to purchase the stock of the dissenting stockholder, and its purchase by the majority stockholders was neither a condition precedent to the renewal of the corporate charter nor a condition subsequent to the continued existence of the corporation (A. 4 and 26). The renewal of the corporate charter was effective upon the expiration of the existing charter (A. 4 and 26).

The dissenting stockholder, Margaret M. Quigley, and the affirmative voting stockholders were unable to agree as to the real value of her Telegraph-Herald stock (A. 17

and 24), and on the 9th day of February, 1962, the affirmative voting stockholders, with the exception of Charles Murphy, Executor of the Estate of Ellen Murphy, Deceased, filed an equitable action (A. 15) in the District Court of Iowa in and for Dubuque County asking the Court to determine and fix the real value of the dissenting shareholder's 379 shares of the common stock of the Telegraph-Herald as of June 9, 1960, pursuant to Section 491.25 of the 1958 Code of Iowa (A. 17). The trial Court, in a decision rendered on May 18, 1963, determined a real value of $1,750 per share (A. 22).

All parties appealed from the real value determination of the District Court of Iowa in and for Dubuque County, to the Supreme Court of Iowa. In a decision filed on February 9, 1965 (A. 5 and 23) the Supreme Court of Iowa determined and fixed the real value of the dissenting shareholder's common stock of the Telegraph-Herald at $1,650 per share, **Woodward v. Quigley**, 257 Iowa 1077, 133 N. W. 2d 38 (1965). The affirmative voting shareholders were granted a rehearing. The Supreme Court of Iowa, in a decision filed on June 30, 1965, modified its initial determination and held that the real value of such common stock was $1,620 per share, **Woodward v. Quigley**, 257 Iowa 1077, 136 N. W. 2nd 280 (1965) (A. 6).

The case of **Woodward v. Quigley** (A. 15) was brought to determine the extent of the liability created by the vote for renewal of the corporate charter, a matter involving a purely private right between the majority and dissenting stockholders (A. 6 and 23). The corporation was not a party thereto and the action did not involve its business operations (A. 15, 20 and 26). The majority stockholders recognized their obligation under the Iowa statute to purchase the stock of the dissenting stockholder (A. 23). Being unable to agree upon the "real value" of the stock in question, the primary, and, in fact, the only purpose of the litigation was to obtain a court determination of the

real value of the stock (A. 17, 21 and 24). Neither a money judgment nor the enforcement of a contract or statutory obligation was sought or determined (A. 17, 20 and 24). Title to the stock was never in question (A. 2, 16, 18, 20 and 24). The Iowa appraisal statute, Section 491.25, under which the equitable action was instituted presupposes that the dissenting stockholder owns the shares which the court is to evaluate (A. 4). Legal title remained in the dissenting stockholder until, on July 16, 1965, the majority stockholders paid for the shares of stock owned by the dissenting stockholder, Margaret M. Quigley (A. 6 and 43).

During the taxable year 1963 the majority stockholders voting to extend the corporate existence of the Telegraph-Herald, with the exception of Charles Murphy, Executor of the Estate of Ellen Murphy, Deceased, paid attorneys', accountants' and appraisers' fees, costs and disbursements in the total of $37,890.75 for services rendered in connection with the determination of the real value of the dissenting shareholder's stock (A. 6).

The Taxpayers, for the taxable year 1963, deducted their proportionate share of the attorneys', accountants' and appraisers' fees, costs and disbursements from their respective adjusted gross incomes, as ordinary and necessary expenses paid for the management, conservation or maintenance of property held for the production of income pursuant to Section 212 of Internal Revenue Code of 1954 (A. 7).

The Commissioner of Internal Revenue disallowed the deductions with the explanation, contained in his Notices of Deficiency, that the amounts claimed "for Professional fees incurred in relation to income producing property are not allowable because the fees represent capital expenditures incurred in connection with the acquisition of capital stock of a corporation, Telegraph-Herald, instead of deductible expenditures" (A. 34).

SUMMARY OF ARGUMENT

The granting of certiorari in this case presents a question most unique while the problem for consideration is as contemporary as "Cash McCall" and has been undoubtedly precipitated and accelerated by a dynamic and vital economy. The question, it is suggested, will ultimately be determined by an analysis of nineteenth century economic history.

Simply stated, the problem involves the characterization for income tax purposes of litigation fees and costs as nondeductible capital expenditures or as ordinary and necessary expenses currently deductible.

Technically stated, the problem involves the determination of the extent to which Section 263 (a)(1) re capital expenditures limits Section 212 (2) re expenses for production of income in areas where fees and costs are incurred in litigation involving title to "property held for the production of income", e. g., stock of a closely held corporation.

The majority stockholders (Taxpayers) paid attorneys', appraisers' and accountants' fees for services rendered in connection with a state court litigation, the primary purpose of which was the judicial determination of the "real value" of a dissenting shareholder's common stock. The equitable action arose under a state appraisal statute granting a dissenting shareholder the right to "get out of the corporation with the 'real value' of her stock" (A. 25). The object or standard inherent in the appraisal statute is "to ascertain the actual worth of that which the dissenter loses because of his unwillingness to go along with the controlling stockholders, that is, to indemnify him" (A. 24).

The Supreme Court of Iowa in its opinion determining the "real value" of the dissenting shareholder's common

stock reviewed the legislative history and development of the Iowa Appraisal Statute and concluded that the transaction precipitated by the refusal of the dissenting shareholder to continue as an investor in the corporation for the renewal period was not to be characterized as a "sale" and purchase transaction but rather as a procedure to pay the dissenting shareholder his aliquot share in the corporation (A. 24 and 25). The Court further explained that the majority shareholders were given the right to continue the corporation in return for the payment to the dissenting shareholder of her fair share of the "real value" of the corporation (A. 27). As twenty years was the life of the corporation, the dissenting shareholder had not bound herself to remain such after the expiration of that definite period of time. Accordingly, she had the right to her proportionate share of the assets of the corporation.

The taxpayers contend that the application of the primary purpose test and/or the test of origin and consequence to the factual situation involved in the state court appraisal action will result in a characterization of the litigation costs and fees as ordinary and necessary expenses re Section 212(2).[3]

---

[3] It is apparent from the Senate Committee Report accompanying the Revenue Act of 1942 that Congress intended that some expenditures pertaining to assets of a purely capital nature were to be allowed as deductions from gross income. . . . "Ordinary and necessary expenses so paid or incurred are deductible under section 23(a)(2) even though they are not paid or incurred for the production or collection of income of the taxable year or for the management, conservation, or maintenance of property held for the production of such income. **The term 'income' for this purpose comprehends not merely income of the taxable year but also income which the taxpayer has realized in a prior taxable year or may realize in subsequent taxable years,** and is not confined to recurring income but applies as well to gain from the disposition of property" (App., infra p. [illegible]).

A-14

ARGUMENT

I

(a). The Court of Appeals, although the only issue presented in the state court litigation out of which expenses in question arose was the real value of the stock owned by the dissenting shareholder—title to such stock not being at issue or in dispute—erred in failing to give effect to the "primary purpose test" which this Court has recognized as controlling in the determination of the character of litigation expenses; e. g.; to differentiate capital expenditures re Section 263 from ordinary and necessary expenses re Sections 162 and 212.

(b). In determining the character of litigation expenses, the controlling test is that of primary purpose; viz., even though title may be involved in the litigation, if the defense of or the perfection of or the acquisition of title is not the primary purpose of the litigation, such expenses are deductible.

The tax law pertinent to the characterization of amounts paid by majority stockholders (Taxpayers) for attorneys', appraisers' and accountants' fees for services rendered in connection with a state court litigation, the primary purpose of which was the judicial determination of the real value of a dissenting shareholder's common stock as either an ordinary and necessary expense re Section 212 (2) or as a capital expenditure re Section 263 is exhaustedly yet lucidly enunciated in this Court's decisions of Bingham v. Commissioner, 325 U. S. 365 (1945); Deputy v. du Pont, 308 U. S. 488 (1939); Kornhauser v. U. S., 276 U. S. 145 (1928); Lykes v. U. S., 343 U. S. 118 (1952); U. S. v. Gilmore, 372 U. S. 39 (1963); Welch v. Helvering, 290 U. S. 111 (1933).

The "primary purpose test", conceived in Kornhauser v. U. S., 276 U. S. 145 (1928), is elaborated and explained in the decisions of Heller v. Commissioner, 2 T. C. 371 (1943), aff'd 147 F. 2d 376 (9th Cir. 1945), cert. denied 325 U. S. 868 (1945); Helvering v. Stormfeltz, 142 F. 2d 982 (8th Cir. 1944); Hilton Hotels Corp. v. U. S., 410 F. 2d 194 (7th Cir. 1969); Industrial Aggregate Company v. U. S., 284 F. 2d 639 (8th Cir. 1960); Manufacturers Hanover Trust Company v. U. S., 312 F. 2d 785 (Ct. Cl. 1963), cert. denied 375 U. S. 880 (1963); Rassenfoss v. Commissioner, 158 F. 2d 764 (7th Cir. 1946); Ruoff v. Commissioner, 30 T. C. 204 (1958), reversed and remanded by 277 F. 2d 222 (3d Cir. 1960); Smith Hotel Enterprises, Inc. v. Nelson, 236 F. Supp. 303 (D. C. Wis. 1964). The primary purpose doctrine as developed in these decisions is used to differentiate capital expenditures of Section 263 from ordinary and necessary expenses under Sections 162 and 212.

The essential facet of the primary purpose doctrine is that it is used to delve deeply into a fact situation to characterize the particular litigation costs as either a capital expenditure or as an ordinary and necessary expense. Accordingly, it is essential that the legislative history and development of the Iowa Appraisal Statute be reviewed and examined.

The action in **State v. Shellsburg Grain & Lumber Co.**, 53 N. W. 2d 143 (Iowa 1952), was ". . . predicated upon Section 491.25, Code of 1946, I. C. A., which states: 'Corporations * * * may be renewed * * * if a majority of the votes cast * * * be in favor of such renewal, **and if those voting for such renewal will purchase at its real value the stock voted against such renewal.**'" The emphasized portion of Section 491.25, ". . . has been in substance the law of this state since the Code of 1851."

In **Woodward v. Quigley**, 133 N. W. 2d 38 (Iowa 1965), the Supreme Court of Iowa outlined the economic and

legislative history pertinent to the Iowa Appraisal Statute as follows on pages 42 and 43 of 133 N. W. 2d; to-wit:

> "The original statute was similar to those enacted in most states to modify the common law rule which required unanimous consent of all the stockholders for a substantial change in the corporate structure. The increase in the number of corporations and stockholders made such a rule impracticable. The statute was enacted to permit a majority to vote to renew the corporate life and at the same time allow a dissenting minority to get out of the corporation with the 'real value' of its stock. It prevented the minority from being squeezed out for a lesser price.
>
> "The U. S. Supreme Court discussed this type of statute in Voeller v. Neilston Warehouse Co., 311 U. S. 531, 61 S. Ct. 376, 85 L. Ed. 322, and in speaking through Justice Black, said:
>
> 'At common law, unanimous shareholder consent was a prerequisite to fundamental changes in the corporation. This made it possible for an arbitrary minority to establish a nuisance value for its shares by refusal to cooperate. To meet the situation, legislatures authorized the making of changes by a majority vote. This, however, opened the door to victimization of the minority. To solve the dilemma, statutes permitting a dissenting minority to recover the appraised value of its shares, were widely adopted.'
>
> "In Iowa prior to 1933, the statute as then worded and interpreted required the majority to purchase the dissenter's stock as a condition precedent to the issuance of a certificate of corporate renewal. In those instances where the majority was unable to finance the purchase of the minority stock, the minority was in a position to force a liquidation against the will of the majority.

"In 1933, the 45th General Assembly attempted to correct this injustice by adding the following sentence:

'Stockholders voting for renewal shall have three years from the date such action for renewal was taken in which to purchase the stock voted against such renewal, which purchase price shall bear interest at eight (now five) percent per annum from the date of such renewal action until paid, * * *.'

"In State ex rel. Robbins v. Shellsburg Grain & Lumber Co., 243 Iowa 734, 739, 53 N. W. 2d 143, 145, we discuss this historical development saying:

" 'It is true * * * the object of the purchase clause in the statute is to protect a minority stockholder against roughshod tactics upon the part of a majority group.' We conclude that the 1933 amendment 'was enacted to protect the majority group in voting for a renewal of the corporate charter. It gave to them a three-year period of grace within which to arrange for payment of the real value of the dissenter's stock, without being harassed by judgments and executions.' We do not here have a question of the issuance of a certificate of renewal or harassment by judgment or executions. We are concerned with the real value of defendant's stock and the amendment did not change the basic purpose of the statute. *The majority was given the right to continue the corporation in return for the payment to the minority of its fair share of the real value of the corporation.*" (Emphasis supplied.)

In **Terrell v. Ringgold County Mut. Telephone Co.**, 282 N. W. 702 (Iowa 1938), at page 704, Justice Mitchell stated as follows in his dissenting opinion; to-wit:

"The United States Supreme Court in Apsey v. Kimball, 221 U. S. 514, 31 S. Ct. 695, 55 L. Ed. 834,

under a somewhat similar law of Congress in connection with the extension of the corporate existence of a National Bank, held that when the election is made by the majority to extend the corporate charter and by the dissenting minority stockholder to withdraw, the latter thereupon ceases to be a shareholder in the corporation."

In **Apsey v. Kimball**, 221 U. S. 514 (1911), this Court speaking through Mr. Justice Day enunciated the legal relationships of the majority shareholders and the dissenting shareholder precipitated by a vote renewing a corporation's existence pursuant to a national banking statute, as follows; to-wit:

"The suits were originally brought by . . . receiver of the First National Bank of Chelsea, Massachusetts, against George E. Kimball . . . under § 5151 of the Revised Statutes of the United States (U. S. Comp. Stat. 1901, p. 3465), making the shareholders of a national banking association individually responsible in a sum equal to the amount of their stock therein at the par value thereof, in addition to the amount invested in such shares.

"In each of the cases the courts whose judgments are here for review reached the conclusion that the shareholder sued was not liable to the receiver on account of such stautory obligation.

* * * * * * * *

"As originally organized, national banks had a corporate existence of twenty years. By the act of July 12, 1882, 22 Stat. at L. chap. 290, p. 162, U. S. Comp. Stat. 1901, p. 3457, such banks were authorized to continue their corporate existence for another twenty years. As pointed out in § 2 of the act, *such extension must be authorized by consent in writing of share-*

holders owning not less than two thirds of the capital stock of the association. Before granting a certificate of approval of such extension, the Comptroller of the Currency is required to cause a special examination of the bank to be made, and if, after such examination, or otherwise, it appears to him that the association is in a satisfactory condition, he is required to grant his certificate of approval, or, if it appear that the condition of the association is not satisfactory, he shall withhold the same.

"Section 5, which is the important one in this case, provides:

'That when any national banking association has amended its articles of association, as provided in this act, and the Comptroller has granted his certificate of approval, any shareholder not assenting to such amendment may give notice in writing to the directors within thirty days from the date of the certificate of approval, *if his desire to withdraw from said association, in which case he shall be entitled to receive from said banking association the value of the shares so held by him,* to be ascertained by an appraisal made by a committee of three persons, one to be selected by such shareholder, one by the directors, and the third by the first two; and in case the value so fixed shall not be satisfactory to any such shareholder, he may appeal to the Comptroller of the Currency, who shall cause a reappraisal to be made, which shall be final and binding; and if said reappraisal shall exceed the value fixed by said committee, the bank shall pay the expenses of said reappraisal, and otherwise the appellant shall pay said expenses; *and the value so ascertained and determined shall be deemed to be a debt due, and be forthwith paid, to said shareholder from said bank; and the shares so surrendered and appraised shall, after due notice, be*

sold at public sale, within thirty days after the final appraisal provided in this section."

* * * * * * * *

"The question then, is: did the shareholders, defendants in error, cease to be such, or were they still shareholders when the bank failed, and liable to assessment for the benefit of creditors? It is the contention of the plaintiff in error that they did not cease to be shareholders until, under § 5 of the act, an appraisal of the value of the stock had been made and the certificates of stock duly surrendered. Upon the other hand, the defendants in error contend that, upon complying with the steps required of them, in giving notice, appointing an appraiser, and using diligence to have an appraisal, *they ceased to be shareholders, and were no longer liable to pay the assessment made.*

"The First National Bank of Chelsea was originally incorporated, under the statute, for a period of twenty years, and while that was its span of corporate life, the defendants in error became shareholders therein, received certificates of shares, and were duly registered as shareholders. *As twenty years was the life of the corporation, the shareholders had not bound themselves to remain such after the expiration of that definite period of time. As the statute originally stood, the venture would necessarily terminate at the end of that time.*

"Congress recognized that it might be proper to continue the organization, that at least a part of the shareholders might desire to do so, and therefore the act of July 12, 1882, provided for the extension of the corporate existence of the bank. It was also recognized that a part of the shareholders might wish to retire from the venture, and it was therefore provided that two thirds of the shareholders must acquiesce to continue the bank's existence, ...

* * * * * * * *

"We agree with the courts below that the defendants ceased to be shareholders after thus complying with the statute. Section 5151 of the statute makes shareholders liable to the assessment. The statute makes specific provision for the manner in which the shareholder may sever his connection with the corporation. These necessary steps were taken, as the agreed facts show. *The shareholders had a right to end their connection with the association at the termination of the period of original incorporation, or, if they so desired, they might go on with the association in its renewed life.*

"Section 5 provides for the manner of manifesting such determination to terminate their relations with the corporation at the expiration of its original life. . . . We cannot agree with the contention of the plaintiff in error, that they ceased to be shareholders only when the appraisal had been made, and the certificate of shares surrendered."

* * * * * * * *

"These shareholders had done all that the law required of them. *Any further action to evidence the changed relation of the shareholders to the bank, upon its books, was not a matter within the control of the shareholders.*

"It is argued that the construction we have given the statute may amount to a reduction of the capital stock, to the detriment of creditors. *The corporation in which these shares were held expired in twenty years. The creditors after that time had no right to hold these shareholders in face of the law, of which all must take notice, permitting the retirement of non-assenting shareholders.* If this results in the diminution of outstanding shares of the bank assessable for creditors, it was the very thing made possible by the amended statute. New shareholders are to be brought

in by the sale of the stock, as provided in § 5. *It is true that these defendants retained their certificates, but they were not obliged to surrender them except upon payment for their shares.*

"It is said, had the corporation made a large gain, instead of failing after the action of these shareholders, in giving notice and naming their appraiser, they might have withdrawn their notice, and obtained the benefit of such increase, but this depends upon the construction of the statute. *As we view it, when the shareholders made their election to retire at the end of the first twenty-year period of corporate organization, and took the steps required* in § 5, by giving notice and appointing an appraiser to obtain a valuation of and payment for their shares of stock, *they thereby ceased to be shareholders beyond the original twenty-year term of the life of the corporation, and they could neither share its profits, nor be compelled to bear its burdens.*" (Emphasis supplied.)

Notwithstanding Judge Matthes of the Court of Appeals (A. 55) and Judge B[illegible]e of the Tax Court (A. 43, Footnote 7) to the contr[illegible] is strenuously urged that an analytical study and review of the Iowa cases cited herein, together with the two opinions of this Court (Viz., Voeller v. Neilston Warehouse Co., 311 U. S. 531 (1941), and Apsey v. Kimball, 221 U. S. 514 (1911), substantiates the Taxpayers' interpretation of the Iowa corporate law (infra, pp. 20-21) relative to the legal rights and allegations of the majority shareholders and the dissenting shareholder arising on June 9, 1960, pursuant to the term and condition of the Iowa Appraisal Statutes.

Admittedly, there is not an overabundance of decisions of the Supreme Court of Iowa interpreting the renewal and appraisal statute. However, it would seem that if the case of Woodward v. Quigley, 133 N. W. 2d 38 (Iowa

1965), is first analyzed in the context in which it was written by Justice Stuart, e. g., as determinative of issues arising in the field of corporate law, the conclusion is inescapable that the policy of Iowa law is in accord with the aforesaid decisions of this Court. For instance, at A. 24 and A. 25, Justice Stuart refuses to discount the value of the dissenting shareholder's common stock for a broker's commission and because it represents a minority interest, for the reason that this is not a **sale of stock** but a judicial determination of real value to idemnify the withdrawing shareholder for that which he loses because of his unwillingness to go along with the controlling stockholders. Justice Stuart is in effect pointing to the crux of this transaction that the purpose of the statute is to provide a procedure that will allow a dissenting shareholder to get out of the corporation with the real value of his stock.

The Supreme Court of Iowa in the case of **Woodward v. Quigley**, 133 N. W. 2d 38 (Iowa 1965), at page 43, cited **Voeller v. Neilston Warehouse Co.**, 311 U. S. 531 (1941), with approval. In the latter case, this Court speaking through Mr. Justice Black stated as follows at pages 535 and 536 of 311 U. S.; to-wit:

> "The objective of the Ohio statute permitting the right of appraisal to dissenting shareholders was the elimination of abuses that had long been a fixture in the field of corporate finance. . . . The corporation was given the right to avoid the effect of being compelled to pay the claimed value either by making a counter-offer or by requesting an appraisal. **In addition, it was given the right to avoid both appraisal and payment of the claimed value by abandoning its original purpose to sell its assets.** The dissenting shareholders could, by requesting an appraisal, likewise avoid accepting the corporation's counter-offer.

Thus the corporation is compelled to pay or the dissenting shareholder to accept payment of the amount of the offer or counter-offer only if none of the many available alternatives are pursued before the expiration of a six-month period.

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"It is true, as respondent urges, that after the majority authorizes the corporation to effect a sale, the alternatives are thereafter expressly open only to the corporation and the dissenters; no provision is made for notice to the majority shareholders as individuals. **But the majority, by their vote approving the sale of assets, have indicated their intention to remain part and parcel of the corporation; the dissenters, on the other hand, by voting against the sale and by demanding payment, have indicated an intention to sever relationships.**" (Emphasis supplied.)

In the normal stock acquisition transaction there exists a willing buyer and a willing seller, neither of which are under any compulsion to buy or sell. In the case now before this Court, such is not the situation. The seller (the dissenting shareholder) was willing enough—she chose to sell her stock by her action in voting against the renewal of the corporate charter of the Telegraph-Herald. But there was no willing buyer—the taxpayers were required by statute to buy the shares of the dissenting shareholders. Thus, an essential ingredient of the normal stock acquisition transaction is missing . . . the willing buyer with a desire to purchase.

In essence, it was the unilateral act of the seller (the dissenting shareholder) that precipitated the sale transaction. The statute, in effect, creates a market for the dissenting shareholder if she wishes to sell her stock, viz., by requiring the majority stockholders to purchase it. The majority shareholders have absolutely no control

over the situation . . . all of the discretions, options and privileges of the statute are conferred upon the dissenting shareholder. If the dissenting shareholder exercises her option to sell her stock . . . by voting against the renewal of the corporation's charter . . . the majority shareholders are compelled to purchase such stock.

Thus, it becomes apparent, **that an involuntary obligation to purchase the stock of the dissenting shareholder has been imposed by statute upon the Taxpayers** (majority shareholders).

A cursory examination and analysis of **Terrell v. Ringgold County Mut. Telephone Co.**, 282 N. W. 702 (Iowa 1938); **State v. Shellsburg Grain & Lumber Co.**, 53 N. W. 2d 143 (Iowa 1952); **Robbins v. Beatty**, 67 N. W. 2d 12 (Iowa 1954); **Woodward v. Quigley**, 133 N. W. 2d 38 (Iowa 1965); **Melsha v. Tribune Publishing Co.**, 51 N. W. 2d 425 (Iowa 1952); **Apsey v. Kimball**, 221 U. S. 514 (1911); and, **Voeller v. Neilston Warehouse Co.**, 311 U. S. 531 (1941) reveals the following relative to the legal relationships of the majority shareholders and the dissenting shareholders subsequent to a vote renewing a corporation's existence pursuant to Section 491.25 of the 1958 Code of Iowa; to-wit:

(1). Every stockholder of an Iowa corporation for pecuniary profit, as an essential element of his contract, has the right to withdraw or retire the capital which he has invested at the termination of the corporation's life or period.

(2). If the majority of the stockholders favor a renewal of the life of the corporation, any stockholder has the election to oppose such renewal.

(3). In the event that the majority of the stockholders vote in favor of renewing the corporate charter, such majority stockholders **MUST PURCHASE** the stock of the dissenting shareholders at

its real value; and conversely, such dissenting shareholders **MUST SELL** their stock to the majority stockholders at its real value. The duty of the majority stockholders (Taxpayers) to purchase the stock of the dissenting stockholder arose as of the date the vote for renewal was taken; e. g., June 9, 1960.

(4). **The statute imposes no duty on the corporation, as such, to purchase the stock of the dissenting stockholder, and its purchase by the majority stockholders is neither a condition precedent to the renewal of the corporate charter nor a condition subsequent to the continued existence of the corporation.**

(5). If the renewal instrument is timely filed with the Secretary of the State of Iowa, the renewal of the corporation's charter will take effect immediately upon the expiration of the corporation's previous period of existence, and in such case, the corporate existence is considered as having been extended without interruption. A certificate for the renewal of the Telegraph-Herald's corporate charter was issued by the Secretary of State for the State of Iowa, on or about June 10, 1960 (A. 4).

(6). When the election is made by the majority stockholders to extend the corporate charter and by **THE DISSENTING MINORITY STOCKHOLDER** to withdraw, the latter thereupon **CEASES TO BE A STOCKHOLDER OF THE CORPORATION**; e. g., the dissenting shareholder is no longer entitled to vote such stock, is no longer entitled to receive any dividends declared on such stock, etc.

(7). The corporation renewing its charter continues to own all of its assets and property free and clear of any lien or liability to the dissenting stockholder.

(8). The dissenting stockholder cannot require that the purchase of his stock by the majority stockhold-

ers be consummated until three years after the date of such action for renewal was taken.

(9). **The dissenting stockholder cannot bring as equitable action for the determination of the real value of his stock until three years after the date of such action for renewal was taken.**

(10). The dissenting stockholder can not have his claim for the real value of his stock adjudicated a lien against the corporation's property.

(11). The dissenting stockholder can not have a receiver appointed to take charge of all of the property, assets and books of the corporation in order to protect his claim.

(12). The Supreme Court of Iowa in **Woodward v. Quigley** (A. 23-27), discussed the object and purpose of the appraisal statute stating as follows, to-wit:

> "Our 'real object is to ascertain the actual worth of that which the dissenter loses **because of his unwillingness to go along with the controlling stockholders**, that is, to indemnify him.' "
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> ". . . **the dissenting stockholder was entitled to receive 'the aliquot proportion** which the number of shares held would be entitled to receive in the distribution of the net amount of the corporate funds in which his particular kind of stock would be entitled to share.' "
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> ". . . **the stockholder is entitled to be paid for that which has been taken from him, viz., his proportionate interest in a going concern.**"
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> ". . . The majority was given the right to continue the corporation in return for the payment

to the minority of its fair share of the real value of the corporation."

(13). The majority stockholders, in addition to paying the dissenting stockholder the real value of his stock, must pay "interest at the rate of five percent per annum from the date of such renewal action until paid".

An application of Section 491.25 of the 1958 Code of Iowa[4] and the foregoing propositions of law to the factual situation now before this Court reveals the following; to-wit:

(1). That the Taxpayers as majority stockholders of the Telegraph-Herald, whose corporate charter was due to expire on November 1, 1961 (A. 3, 18), had no alternative but to comply "with the provisions of this section," if the Telegraph-Herald was to continue in business as a corporate entity;

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[4] Section 491.25 of the 1958 Code of Iowa provides a statutory procedure for the determination of the rights of the affirmative voting common stock shareholders and the dissenting common stock shareholders in the case of a corporation existing for a period of years, when the majority of such common stock shareholders vote to renew its corporate charter. The pertinent portion of the statute is as follows; to-wit:

"491.25 Renewal—Conditions. Corporations existing for a period of years may be renewed . . . to exist perpetually upon compliance with the provisions of this section . . . The right of renewal is vested in the stockholders and shall be exercised by a resolution thereof adopted at any regular meeting or at any special meeting called for that purpose. Such resolution must be adopted by a majority of all the votes cast at such meeting, or by such other vote as is authorized or required in the company's existing articles of incorporation."

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"In all cases of renewal, those stockholders voting for such renewal must purchase at its real value the stock voted against such renewal, and shall have three years from the date such action for renewal was taken in which to purchase and pay for the stock voting against such renewal . . ."

(2). That the extension of the life of the corporation was essential to the management of the Taxpayers' investment in the common stock of the Telegraph-Herald;

(3). That "the right of renewal is vested in the stockholders and shall be exercised by a resolution thereof adopted . . . at any special meeting called for that purpose . . ." (A. 11);

(4). That "such resolution must be adopted by a majority of all the votes cast at such meeting . . ." (A. 14);

(5). That if the resolution authorizing a renewal of the corporation's existence is adopted "THOSE STOCKHOLDERS VOTING FOR SUCH RENEWAL MUST PURCHASE . . . THE STOCK VOTED AGAINST SUCH RENEWAL. . . ."

The conclusion is inescapable that the renewal statute, Section 491.25, contains and imposes, "in all cases of renewal," an absolute obligation upon "those stockholders voting for such renewal" to purchase the stock of the dissenting shareholders at its real value. The net effect of the statutory requirement that the majority shareholders "MUST PURCHASE" the dissenting shareholder's stock is **the imposition on such majority shareholders of an involuntary obligation to purchase such stock.**

The trial court in the case of **Woodward v. Quigley** characterized the nature of the majority shareholder's statutorily imposed involuntary obligation to purchase such stock as follows (A. 21); to-wit:

"3. That plaintiffs (together with owner of 10 shares of Murphy stock) voted for the renewal of the corporate charter of Telegraph-Herald on June 9, 1960, and have the obligation to purchase defendant's 379 shares of stock of Telegraph-Herald at its 'real value' under Section 491.25, Code of Iowa,

plus interest thereon at the rate of 5% per annum from June 9, 1960, until paid."

The Iowa Supreme Court in **Woodward v. Quigley,** 133 N. W. 2d 38 (Iowa 1965), characterized the nature of the majority shareholders' statutorily imposed involuntary obligation to purchase such stock as follows (A. 24); to-wit:

"Plaintiffs recognize their obligation to purchase the stock under this statute, but the parties have been unable to agree on the 'real value' of defendant's stock. This action was brought by the majority stockholders to secure a court determination of its 'real value'."

The Court in **Smith Hotel Enterprises, Inc. v. Nelson,** 236 F. Supp. 303 (D. C. Wisc. 1964), recognized the significance of the involuntary obligation of the corporation to purchase the stock of a shareholder dissenting to a sale of substantially all of the corporation's assets under a Wisconsin appraisal statute stating as follows on page 305 of 236 F. Supp.; to-wit:

"Counsel for the plaintiff urges that the decision in Boulder is unsound in that it disregards the fact that **the taxpayer's obligation to purchase the dissenters' stock was an involuntary obligation.** Under the Oklahoma statute, as well as under the Wisconsin statute, **once the dissenters have demanded that the corporation purchase their shares at fair value, the corporation has no choice in the matter. After the demand has been made, the corporation's main concern is with keeping its liability to a minimum.** Plaintiff's argument is sound. Viewed in this light it appears that the primary purpose of the state litigation in the instant case was as a determination of the fair value of the shares, and the involvement of title was incidental. The deduction made by the taxpayer was

proper as an ordinary and necessary business expense."

In the case of **Industrial Aggregate Company v. United States,** 284 F. 2d 639 (8th Cir. 1960), the Court premised its decision that the litigation expenses in question incurred by the Taxpayers in the state court action were NOT for the defense or perfection of title, upon the "primary purpose test"—recognized as controlling in the determination of the character of litigation expenses—stating as follows on page 645 of 284 F. 2d; to-wit:

> "At the same time, ever since **Kornhauser v. United States,** 276 U. S. 145, 48 S. Ct. 219, 72 L. Ed. 505, cases recognize that the mere fact that title to property happens to be involved in litigation does not necessarily mean that expenditures of that litigation are automatically rendered nondeductible by the regulation. An example is **Levitt & Sons v. Nunan,** 2 Cir., 142 F. 2d 795, 797. Practicality and substance are to be recognized. The test which appears to have been established is that of primary purpose. Thus, if the primary or sole purpose of the suit is to perfect or defend title, the expenditures are not deductible. **Shipp v. Commissioner,** 9 Cir., 217 F. 2d 401, 402; **Lewis v. Commissioner,** 2 Cir., 253 F. 2d 821, 827-828; **Garrett v. Crenshaw,** 4 Cir., 196 F. 2d 185, 187; **Addison v. Commissioner,** 8 Cir., supra, at page 523 of 177 F. 2d. On the other hand, even though title may be involved, if its defense or perfection is not the primary purpose of the litigation, the expenditures do not encounter the barrier of the regulation's standard and they may qualify instead as ordinary and necessary expenses. **Rassenfoss v. Commissioner,** 7 Cir., 158 F. 2d 764, 767-768; **Sergievsky v. McNamara,** D. C. S. D., N. Y., 135 F. Supp. 233, 237-238; **Straub v. Granger,** D. C. W. D., Pa., 143 F. Supp. 250, 254-255."

In applying the "test of purpose" the Court stated as follows on page 647 of 284 F. 2d; to-wit:

"Thus the pleadings themselves, the agreed facts and the stipulation for settlement all compel the conclusion that the primary purpose of Oakland's institution of the state court litigation, of the taxpayer's defense of it, and of both parties in effecting the settlement, was one and the same, namely, the resolution of the issue of the taxpayer-lessee's alleged violations of the operating covenants of the four leases. That the determination of this issue involved the taxpayer's consequent right, or lack of right, to the extension, and thus involved continuing title to the leaseholds as extended, does not make this purpose any less primary."

(Footnotes Omitted.)

An application of the "primary purpose" test in the manner prescribed in **Industrial Aggregate Company v. U. S.**, 284 F. 2d 639, 646 (8th Cir., 1960) to the exhibits and stipulation of facts contained in the case now before this Court reveals the following; to-wit:

(1). An examination of the prayer for relief contained in **Exhibit 2**, the Petition in Equity filed in the District Court of Iowa pursuant to the Iowa appraisal statute, discloses that the primary and only **purpose** of the litigation was to fix and determine the real value of the stock owned by the dissenting shareholder (A. 17); to-wit:

"Wherefore, **Plaintiffs ask that the Court determine and fix the real value** of the Defendant's Telegraph-Herald capital stock as of June 9, 1960, for costs and for such other and further relief as shall be just and equitable."

The governing **purpose** in the case of **Sergievsky v. McNamara**, 135 F. Supp. 233 (D. C. N. Y. 1955) was found in the nature of the relief sought. In the case at

bar, as shown in the prayer, the relief sought by the taxpayers in the State Court litigation was the determination of the real value of the dissenting shareholder's stock.

(2). An examination of **Exhibit 3**, the decision of the District Court of Iowa, discloses that the primary and only **purpose** of the litigation was to fix and determine the real value of the stock owned by the dissenting shareholder (A. 21); to-wit:

"2. **This is an equitable proceeding to fix and determine the real value** of defendant's 379 shares of stock in the Telegraph-Herald corporation as of June 9, 1960, under Section 491.25 Code of Iowa, said stock having been voted against renewal of the corporate charter on said date."

The governing **purpose** in the case of **Rassenfoss v. Commissioner**, 158 F. 2d 764 (7th Cir. 1946) was found in the reason why the plaintiff was suing the taxpayer. In the case at bar, as shown in District Court's Opinion, the majority shareholders' reason or **purpose** for bringing the equitable action against the dissenting shareholder was to determine the real value of her Telegraph-Herald common stock.

(3). An examination of the case of **Woodward v. Quigley**, 133 N. W. 2d 38 (Iowa 1965), discloses that the primary and only **purpose** of the litigation was to fix and determine the real value of the stock owned by the dissenting shareholder (A. 24); to-wit:

"**This action was brought by the majority stockholders to secure a court determination of its 'real value.'**"

The governing purpose in the case of **Kornhauser v. U. S.**, 276 U. S. 145 (1928), focused upon the issue in the prior litigation. In the case at bar, as shown in the Iowa Supreme Court's opinion, the issue involved in the state

court litigation was the real value of common stock owned by the dissenting shareholder.

(4). An examination of the Stipulation of Facts (A. 1) discloses that the primary and only **purpose** of the litigation was to fix and determine the real value of the stock owned by the dissenting shareholder; to-wit:

> "11. . . . **The majority stockholders, . . . filed a Petition in Equity in the District Court of Iowa, in and for Dubuque County asking the Court to determine and fix the real value** of Margaret M. Quigley's stock" (A. 5).
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> "14. **During the taxable year 1963 the majority stockholders . . . paid attorneys', accountants' and appraisers' fees, costs and disbursements** in the total amount of $37,890.75 **for services rendered in connection with the determination of the real value** of Margaret M. Quigley's stock . . ." (A. 6).
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> "19. **Respondent concedes that the fees, costs and disbursements, paid by Petitioners . . . were reasonable in amount . . . and . . . were incurred in connection with the determination of the real value** of Margaret M. Quigley's shares of stock in the Telegraph-Herald" (A. 7).

The governing purpose in **Str[illegible] v. Granger,** 143 F. Supp. 250 (D. C. Pa. 1956), was a[illegible]ertained by emphasizing the **purpose** for which the taxpayer consulted and retained counsel. In the case at bar, as shown in the Stipulation of Fact 14 (A. 6) the **purpose** for which the Taxpayers consulted and retained counsel was ". . . in connection with the determination of the real value of Margaret M. Quigley's stock . . ."

Accordingly, it is respectfully submitted that an analysis of the pleadings, the stipulation of facts, the opinion

of the District Court of Iowa and the opinion of the Supreme Court of Iowa compel the following conclusions; to-wit:

(1). That the litigation expenses in question were paid by the Taxpayers during calendar year 1963 (A. 6).

(2). That the litigation expenses were reasonable in amount and were incurred in connection with the determination of the real value of Margaret M. Quigley's, the dissenting shareholder's, shares of stock in the Telegraph-Herald (A. 7).

(3). That the primary purpose of the majority shareholders' (Taxpayers') institution of the state court litigation was the determination of the "real value" of the stock owned by the dissenting shareholder (A. 24).

(4). That the litigation expenses **WERE NOT INCURRED** by the majority shareholders (Taxpayers) in the defense of or in the perfection of or in the acquisition of title to the stock owned by the dissenting shareholder.

(5). That the litigation expenses incurred and paid by Taxpayers in connection with the state court action are deductible under the provisions of Section 212 of the Internal Revenue Code of 1954, as ordinary and necessary expenses[5] paid for the management, conservation or maintenance of property held for the production of income.

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[5] For an illuminating and pertinent discussion of some of the guideposts erected by the courts in their determination of whether particular transactions constitute ordinary and necessary expenses, refer to the opinion of Judge Benjamin Cardozo in **Welch v. Helvering**, 290 U. S. 111 (1933), at page 114. In **Deputy v. du Pont**, 308 U. S. 488, 60 S. C. 363, 84 LE 416 (1939), the Supreme Court stated ". . . an expense may be ordinary though it happens but once in the taxpayer's lifetime".

II

(a). **The Court of Appeals erred in holding that amounts paid by majority shareholders (Taxpayers) for attorneys', appraisers', and accountants' fees and expenses were capital expenditures incurred in connection with the acquisition of the title to stock owned by a dissenting shareholder; even though the primary purpose of the state court litigation out of which the expenses arose was the determination of the "real value" of the stock owned by the dissenting shareholder.**

(b). **The Title to the stock of the Telegraph-Herald owned by the dissenting shareholder, Margaret M. Quigley, was not at issue and/or in dispute in the equitable action entitled** F. W. WOODWARD, ET AL. v. MARGARET M. QUIGLEY **brought in the District Court of Iowa In and For Dubuque County or in the subsequent appeal and rehearing before the Supreme Court of Iowa.**

The Court of Appeals, disallowed the majority shareholders' (Taxpayers) deductions for amounts paid during 1963 for attorneys', accountants' and appraisers' fees for services rendered in connection with the judicial determination of the real value of the dissenting shareholders' 379 shares of the common stock of the Telegraph-Herald cn the premise and assumption that such expenses were incurred in the acquisition of the title to the dissenting shareholders' stock. In other words, the Court of Appeals' holding of nondeductibility was based upon its contention that the title to the stock owned by the dissenting shareholder was acquired as a result of (or by reason of) litigation which precipitated the expenditures. The Court of Appeals stated as follows (A. 49); to-wit:

"The general rule is that expenses incurred in acquiring or disposing of property are capital expenditures . . . The expenditures here fall within that category. They "re-

lated directly" to the acquisition of capital assets . . . The property would never have been acquired had not the value been established and paid" (A. 58).

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"The transaction involved here was the purchase of capital assets. The valuation of these assets was vital to the purchase, and the litigation necessary for valuation was thus an integral part of the overall transaction" (A. 60).

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"What we have here, however, is litigation directly connected with the purchase of property. The expenses were incurred to establish the value of the capital assets acquired . . . They were part of the cost of acquisition" (A. 56).

The sense of the last sentence is not readily apparent unless it is interpreted to mean—"Cost of acquisition . . . **of the title** . . . to property are not deductible". The statutory and regulatory authorities cited by the Court of Appeals in support of its decision are Section 263 of the Internal Revenue Code of 1954 (App., infra p. A-4) and Sections 1.263 (a)-2 (c) and (e) of the Regulations promulgated thereunder (App., infra pp. A-9 and A-10) as well as Section 1.212-1 (k) and (n) of the Regulations (App., infra pp. A-8 and A-9). An examination thereof reveals that the frame of reference involved is—**TITLE**—. It is "defending title to property", or, "perfecting title to property", or, acquiring title to property that constitutes . . . "the barrier of the regulations standard".[6]

Stripping the rationale of the Court of Appeal's decision to its bare essentials and paraphrasing such essentials in the context of the Regulation's standard of title reveals the premises upon which the decision rests; to-wit:

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[6] **Industrial Aggregate Company v. U. S.**, 284 F. 2d 639, 645.

(1). **Acquisition of the title to the stock depended upon a determination of its real value.**

(2). **Title to the stock was perfected as a result of the Taxpayer's expenditures.**

The Court of Appeal's first premise . . . **Acquisition of the title to the stock depended upon a determination of its real value** . . . is unfounded in fact and unsupported by reasoned analysis. A consideration of the following, it is submitted, points up the fallacy of this premise; to-wit:

(1). That a contract of sale arose by operation of law as a result of the action taken on June 9, 1960 at the special meeting of the stockholders;[7]

(2). That pursuant to the terms and conditions of Section 491.25 of the 1958 Code of Iowa the statutorily imposed contract of sale became effective and binding on the majority shareholders and the dissenting shareholder on June 9, 1960;

(3). That whatever interest, property right, ownership, title, etc., the majority shareholders acquired in and to the dissenting shareholder's stock was acquired on June 9, 1960,[8] **approximately twenty months**

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[7] The cases of **Woodward v. Quigley**, 136 N. W. 2d 38 (Iowa 1965); **Terrell v. Ringgold County Mut. Telephone Co.**, 282 N. W. 702 (Iowa 1938); **State v. Shellsburg Grain and Lumber Co.**, 53 N. W. 2d 143 (Iowa 1952); **Robbins v. Beatty**, 67 N. W. 2d 12 (Iowa 1954); **Melsha v. Tribune Publishing Co.**, 51 N. W. 2d 425 (Iowa 1952); **Apsey v. Kimball**, 221 U. S. 514 (1911); and, **Voeller v. Neilston Warehouse Co.**, 311 U. S. 531 (1941); establish the legal relationships of the majority shareholders and the dissenting shareholder precipitated by a vote renewing a corporation's existence pursuant to Section 491.25 of the 1958 Code of Iowa.

[8] Subject, of course, as in all contracts of sale, to the payment of the purchase price. Analytically, upon the adoption of the resolution authorizing the renewal of the corporation's existence the majority shareholders acquired equitable title in and to the stock and the dissenting shareholder retained legal title as security.

PRIOR to their consultation with any attorney, appraiser, accountant, etc.

In essence, the statute creates a mandatory contract of sale containing the following terms; to-wit:

(a). **Seller**: dissenting stockholders—**(Margaret M. Quigley)**

(b). **Buyer**: majority stockholders—**(Taxpayers)**

(c). **Commodity Sold**: shares owned by dissenting stockholder in corporation—**(379 shares)**

(d). **Date of Contract**: date such action of renewal was taken—**(June 9, 1960)**

(e). **Purchase Price**: the real value of the shares of stock

(f). **Terms**: the purchase price shall bear interest at the rate of five per cent per annum from the date of such renewal action until paid.

(g). **Date of Payment**: ". . . shall have three years from the date such action for renewal was taken in which to purchase and pay for the stock . . ."

The crux of this transaction's chronology, so far as the acquisition or vesting of title is concerned, was **June 9, 1960.** On that day, by force and effect of the statute,[9] equitable title to the stock passed from the dissenting shareholder to the majority shareholders. The dissenting shareholder, of course, retained "bare" legal title for purposes of security; viz., payment of the purchase price. In other words, on **June 9, 1960,** the "die was cast", e. g. the dissenting shareholder had to sell and the majority

[9] Pursuant to the terms and conditions of Section 491.25 of the 1958 Code of Iowa, if the resolution authorizing a renewal of the corporation's existence is adopted ". . . those stockholders voting for such renewal must purchase . . . the stock voted against such renewal . . ."

shareholders had to buy, pursuant to the terms of a statutorily imposed contract of sale. By operation of the statute . . . on **June 9, 1960** . . . the incidences of ownership in and to the dissenting shareholder's stock were conclusively established.

It is, "Hornbook" law that whatever interest, property right, ownership, title, etc., that the majority shareholders acquired in and to the dissenting shareholder's stock was acquired on **June 9, 1960.** Accordingly, the Court of Appeal's premise that . . . **Acquisition of the title to the stock depended upon a determination of its real value** . . . is demonstrably inaccurate and in error. The conclusion is obvious, of course, that **since the majority shareholders acquired title to the dissenting shareholder's stock on June 9, 1960 . . . it would be patently impossible for the determination of the stock's real value on June 30, 1965 to be a factor in an event,** the acquisition of title by the majority shareholders, **that happened over five years prior.**[10]

The Court of Appeal's second premise . . . **Title to the stock was perfected as a result of the taxpayer's expenditures** . . . is likewise unfounded in fact and unsupported by reasoned analysis. A consideration of the following, it is submitted, points up the fallacy of this premise; to-wit:

(1). that the dissenting stockholder, Margaret M. Quigley, had "**PERFECT**" title in and to 379 shares of the common stock of the Telegraph-Herald on **June 9, 1960**[11] (A. 3, 16, 19, 21, and 23);

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[10] The real value of the dissenting shareholder's stock was finally determined by the Iowa Supreme Court on June 30, 1965; **Woodward v. Quigley,** 136 N. W. 2d 280.

[11] See infra, pp. 39 and 40 for a discussion of the "quality" and deprivation of the dissenting shareholder's title in and to the stock.

(2). that on June 9, 1960, the majority stockholders acquired, by force and effect of Section 491.25 such title to the stock as the dissenting stockholder possessed;

(3). that once the dissenting shareholder voted against renewing the corporation's existence, the primary concern of the majority stockholders was keeping their liability to a minimum;

(4). **that subsequent to June 9, 1960, the majority stockholders retained attorneys, appraisers and accountants for the sole purpose of keeping their liability to the dissenting stockholder to a minimum**; and

(5). that the amounts paid by the majority stockholders for attorneys', accountants' and appraisers' fees, costs and disbursements IN NO WAY INCREASED, ADDED TO OR BETTERED THE VALUE OF THE STOCK, e. g., perfected the title to the stock.

This Court's attention is directed to the dissent of Judge Forrester in the U. S. Tax Court case of **Ruoff v. C. I. R.**, 30 T. C. 204 (1958), reversed and remanded by 277 F. 2d 222 (3 Cir. 1960), wherein he points out the "legal quicksand" upon which the Tax Court's "theory" in the case at bar is premised. The "primary issue" of the litigation, as determined by the Third Circuit on appeal, was not ownership, but rather possession of property. Judge Forrester states that a study of the decisions pertinent to the issue of deductibility of legal fees and litigation expenses reveals the following principles of law at pages 226-227 of 30 T. C.; to-wit:

(1). ". . . that without substantial exception, the decisions which have used the touchstone of 'defense of title' to require capitalization treatment involve

factual situations where the title, at the time of taxpayer's original acquisition, was, or was alleged to be clouded. . . ."

(2). ". . . Sections 23(a)(2) and 24(a)(2) and the regulations thereunder, none of which, . . . requires or intends further capitalization treatment after taxpayer has once acquired a **perfect** title which is **unquestioned.**"

(3). The type of ". . . cost of DEFE[illegible] or PERFECTING title to property . . ." which . . . constitutes a part of the cost of the property and is not a deductible expense . . . is limited to those cases where the claimed expense sought to be deducted as such has in fact **increased, added to** or **bettered,** the value of the property upon which it was expended. . . ."

(4). the word "perfecting" as used in the phrase "perfecting title" in the regulations ". . . obviously means making perfect, thereby adding to and enhancing the value of the previously imperfect title to property . . ."

The Court of Claims in **Manufacturers Hanover Trust Co. v. U. S.**, 312 F. 2d 785 (1963), adopted this theory stating that "Under the view of Judge Forrester, dissenting in **Ruoff v. Commissioner**, 30 T. C. 204, 226-227 (1958), the proscription of the deduction of litigation expenses involved in perfecting or defending title applies only to situations where, at the time of the taxpayer's original acquisition, the title was, or was alleged to be, clouded." (at footnote 5 on page 790 of 312 F. 2d.)

The dissenting shareholder, Margaret M. Quigley, acquired the title to the 379 shares of the common stock of the Telegraph-Herald by bequest from her husband, Joseph C. Quigley, who died January 22, 1952 (A. 20).

Upon completion of the transfer from the decedent, Joseph C. Quigley, to his devisee, Margaret M. Quigley, on the books and records of the Telegraph-Herald and delivery to her of the certificate for the 379 shares of common stock, the transferee acquired "**PERFECT**" title to such stock. This transfer was disputed by no one. Parenthetically, such transfer was authorized by the District Court of Iowa, in and for Dubuque County as part of the probate proceedings of the decedent's Estate.

On June 9, 1960, Margaret M. Quigley, the dissenting shareholder, owned and had title in and to the same 379 shares of the common stock of the Telegraph-Herald that she acquired from her husband by bequest in 1952 (A. 3, 16, 19, 21 and 23).

It is obvious that counsel for the Commissioner of Internal Revenue considered that the dissenting shareholder's title in and to such 379 shares was "**PERFECT**" on June 9, 1960, or he would have characterized her title to such shares as being "imperfect" when drafting the stipulation of facts (A. 3).

As Judge Mellott of the U. S. Tax Court stated in **Heller v. C.I.R.**, 2 T. C. 371 (1943) (the litigation expenses involved therein having been precipitated by the taxpayer-shareholder's dissenting vote to a contemplated merger or consolidation arising under a California appraisal statute), at page 374 of 2 T. C.; to-wit:

> "THE STATUTE UNDER WHICH IT WAS INSTITUTED PRESUPPOSES THAT THE 'DISSENTING SHAREHOLDERS' OWN THE SHARES WHICH THEY ARE SEEKING TO HAVE APPRAISED."

The conclusion that Margaret M. Quigley, the dissenting shareholder, had perfect title to such stock on June 9, 1960, is inescapable. On June 9, 1960, the Taxpayers

acquired the dissenting shareholder's perfect title in and to such stock by operation of law. Accordingly, the Court of Appeal's premise that . . . **Title to the stock was perfected as a result of the Taxpayers' expenditures** . . . is demonstrably inaccurate and in error.

In the case of **Heller v. Commissioner,** 2 T. C. 371 (1943), aff'd 147 F. 2d 376 (9 Cir. 1945), cert. denied 325 U. S. 868 (1945), the issue was whether legal fees and expenses paid by a dissenting stockholder, in connection with litigation to determine the value and to enforce his rights to the cash value of his shares pursuant to a California statute providing that stockholders not consenting to a merger or consolidation were entitled to be paid such value, were deductible as expenses for the production for collection of income or in the management of property held for the production of income.

At page 372 the Court stated as follows; to-wit:

> "Respondent contends that the amount of $2,145 paid by petitioner to attorneys during 1937 should be capitalized. Petitioner contends that is is deductible as expense.
>
> Section 23(a) of the Revenue Act of 1936 was amended by section 121 of the Revenue Act of 1942 to allow the deduction of non-trade and non-business expenses.
>
> * * * * * * * *
>
> Respondent urges that the attorneys' fee was incurred in a matter pertaining to assets of a purely capital nature; that the litigation actually involved a defense by petitioner of his rights in, and his title to, these assets; and that the expenditure, being a capital one, was not a deductible expense for 1937.
>
> * * * * * * * *
>
> The report of the Finance Committee which accompanied H. R. 7378 and which as amended became the

Revenue Act of 1942, in discussing the amendment to section 23(a) providing for the deduction of non-trade or non-business expenses, contains the following statement:

> 'Expenses to be deductible under section 23(a)(2) must be ordinary and necessary, which rule presupposes that they must be reasonable in amount and must bear a reasonable and proximate relation to the production or collection of income, or to the management, conservation, or maintenance of property held for that purpose.'

It is obvious from the above that Congress intended that some expenditures pertaining to assets of a purely capital nature were to be allowed as deductions from gross income. Other statements in the report clearly indicate that this is so. Thus, in referring to the term 'income' it is said that it 'comprehends not merely income of the taxable year but also income which the taxpayer has realized in a prior taxable year or may realize in subsequent years, and is not confined to recurring income but applies as well to gain from the disposition of property.'

The attorneys' fee paid by petitioner, while relating to a capital asset, bore a reasonable and proximate relation to the production or collection of income, and to the management of property held for that purpose. **The litigation did not, as** respondent urges, **involve a defense by petitioner of his rights in, and his title to, the stock. The statute under which it was instituted presupposes that the 'dissenting stockholders' own the shares which they are seeking to have appraised. The litigation concerned the exercise by petitioner of his right to receive cash for his shares and the determination of the amount thereof,** he not having approved the contemplated merger or consolidation and having taken the other

steps required by the statute. As a result of that litigation the fair market value of his stock was determined and paid to him in 1938. The attorneys' fee in our judgment was paid for services rendered in connection with 'the production or collection of income,' and in connection with 'the management * * * of property held for the production of income.' Respondent therefore erred in disallowing the claimed deduction."

The decision of the Tax Court on this particular issue was affirmed on appeal by the Court of Appeals for the 9th Circuit in 147 F. 2d 376, cert. denied, at 325 U. S. 868.

The proposition of law established by the Tax Court in **Heller v. Commissioner**, 2 T. C. 371 (1943), was reaffirmed in the case of **Hilton Hotels Corp. v. United States**, 410 F. 2d 194 (7th Cir. 1969), and in the case of **Smith Hotel Enterprises, Inc. v. Nelson**, 236 F. Supp. 303 (E. D. Wis. 1964). The latter was an action brought by a corporate taxpayer for the refund of additional taxes paid when the District Director disallowed deductions taken on the corporation's 1959 income tax return for expenditures made for legal and professional services rendered in a litigation to determine the "fair value" of a dissenting shareholder's minority interest in the corporation, such action being predicated upon a Wisconsin appraisal statute.

The Court held as follows on page 304 of 236 F. Supp.; to-wit:

"The District Director disallowed the deduction claimed for the expenses incurred in the litigation with the shareholder on the ground that they were capital expenditures made for the acquisition of the shares owned by the dissenting shareholder.

The taxpayer contends that the fact that title to property may be involved in litigation does not auto-

matically render expenses incurred in that litigation non-deductible. The test established, it is argued, requires a determination of the **primary purpose** of the litigation. **Industrial Aggregate Company v. United States**, 284 F. 2d 639 (8th Cir. 1960).

The plaintiff argues that under the facts of the present case, any question of title was incidental. **Under the Wisconsin statute the corporation was required to purchase the stock of the dissenting shareholder. The only purpose of the action in Circuit Court was to determine the fair value of the shares. The taxpayer's purpose in the state litigation was to keep its liability to a minimum.**

In support of this position the taxpayer cites **Heller v. Commissioner**, 2 T. C. 371 (1943), aff'd 147 F. 2d 376 (9th Cir. 1945), cert. denied 325 U. S. 868, 65 S. Ct. 1405, 89 L. Ed. 1987, as a case directly in point. There a taxpayer was allowed to deduct litigation expenses incurred in an action he brought for a determination of the fair value of his shares in a merging company. The action was brought under a California statute giving to shareholders dissenting to merger or consolidation the same relief as the Wisconsin statute here involved. The Tax Court rejected the argument that the litigation expenses should be capitalized.

* * * * * * * *

The government urges that the deduction here was properly disallowed and relies on the case of **Boulder Building Corporation v. United States**, 125 F. Supp. 512 (W. D. Okla. 1954), to support its position. There minority shareholders dissented to the extension of the life of the corporation and an enlargement of the corporate powers. They commenced an action to fix the value of their shares under an Oklahoma statute similar to § 180.72 of the Wisconsin Statutes. The

court ruled that the litigation expenses were nondeductible because they were paid in connection with the acquisition of stock. The court distinguished the Atwater case, supra, on the ground that the focal point of that case was the legal effect of an employment contract.

Counsel for the plaintiff urges that the decision in Boulder is unsound in that it disregards the fact that the taxpayer's obligation to purchase the dissenters' stock was an **involuntary obligation.** Under the Oklahoma statute, as well as under the Wisconsin statute, once the dissenters have demanded that the corporation purchase their shares at fair value, the corporation has no choice in the matter. **After the demand has been made, the corporation's main concern is with keeping its liability to a minimum. Plaintiff's argument is sound. Viewed in this light it appears that the primary purpose of the state litigation in the instant case was a determination of the fair value of the shares, and the involvement of title was incidental.** The deduction made by the taxpayer was proper as an ordinary and necessary business expense."

The deductibility of litigation expenses incurred in actions involving corporate stock has been upheld in the following cases, analogous in respect to the application of the legal theory involved in the case at bar.

In **Naylor v. Commissioner of Internal Revenue,** 203 F. 2d 346 (5th Cir. 1953) the taxpayer owned stock in the Lane Drug Stores, Inc. He gave an option on his Lane Drug Stores, Inc. Stock to Interstate Drugs, Inc. Interstate gave notice of exercise of its option and set forth in such notice what it intended to pay taxpayer for his Lane Drug Stores, Inc. Stock. The Court, at page 346 of 203 F. 2d, stated as follows, to-wit:

"The option agreement provided that Interstate should pay for such shares so purchased the net asset value thereof as shown by the books of Lane Drug Stores, Inc., on the last day of the month preceding the date on which the purchase or sale was consummated.

The exercise on September 4, 1946, by the Company of its undisputed right to purchase petitioner's stock effectively converted the agreement of June 1, 1942, into a binding contract of sale, since it constituted an acceptance of petitioner's outstanding offer to sell; but **a dispute arose between the parties as to the net asset value of the shares** as shown by the books of Lane Drug Stores on the last day of the month preceding the date on which the purchase or sale was consummated. The option agreement repeatedly referred to the purchase or sale as being 'consummated' when the party formally exercised its right to purchase said stock.

Since the sale was consummated except as to the delivery of the stock and the payment of the purchase price, the petitioner did not need and did not employ a broker to sell his stock, but employed a lawyer to negotiate, and if necessary to sue, for the purchase money due him under the contract. The Interstate Company had previously given notice to the petitioner that it was exercising its option to buy this stock for $440,000, the asserted option price. The amount paid his attorney by the petitioner was for services leading to the petitioner receiving $580,000 for delivering his stock to the purchaser under the option. This was $140,000 above the price at which the company had purported to exercise its option."

The taxpayer deducted his legal expenditures as ordinary and necessary expenses pursuant to Section 23(a)(2) of the Internal Revenue Code of 1939, the comparable

Section in the Internal Revenue Code of 1954 is Sec. 212. The Commissioner disallowed such deduction, claiming that the legal expenses were capital expenditures incurred in the acquisition of stock. The Court in rejecting the Commissioner's contention stated as follows on page 347 of 203 F. 2d; to-wit:

> "**There was no dispute about the title to the stock or petitioner's duty to deliver it. The controversy was over the amount due him upon delivery thereof.** The situation called for the services of an attorney to collect the proceeds of a sale of a capital asset. **Petitioner's attorney was employed after an enforceable contract sale existed.**"

Likewise, in the case now before this Court, there was no dispute about the title to the stock owned by the dissenting shareholder or the majority shareholders' (Taxpayers') duty to purchase it. The controversy, in the state court litigation, was over the "real value" of the stock of the dissenting shareholder. Similarly, in the **Naylor v. C. I. R.** case the dispute arose ". . . as to the net asset value of the shares. . . ." The situation called for the services of attorneys', appraisers' and accountants' to determine the "real value" of such stock pursuant to the terms and conditions of the Iowa appraisal statute, Section 491.25 of the 1958 Code of Iowa (A. 6). **The majority shareholders' attorneys, etc. were employed,** viz., the equitable action in the District Court of Iowa in and for Dubuque County asking the Court to fix and determine the real value of the dissenting shareholders' common stock was filed on February 9, 1962, **twenty-one months after the majority shareholders were legally obligated to purchase the stock owned by the dissenting shareholder** (A. 6).

In **William C. Atwater & Co. v. Commissioner of Internal Revenue,** 10 T. C. 218 (1948), a former employee of the taxpayer company brought suit to require the repur-

chase of stock held by such employee upon the termination of his employment. The obligation to repurchase the stock was set forth on the stock certificates. The company incurred litigation expense in defending the action. The Tax Court found the litigation expense to be deductible.

The language of the Court in supporting its finding of deductibility is particularly applicable to the factual situation now before this Court. The Court therein states on page 248 of 10 T. C.:

> "**These facts in substance show that in the litigation with Steinbugler petitioner was not endeavoring to acquire any capital assets. It was not defending the title to any stock which it already owned.** On the contrary, it was strenuously resisting the suit of Steinbugler, a former employee, in the regular course of its business. The very essence of this litigation was Steinbugler's effort to enforce an employment contract to repurchase the stock at a price which Steinbugler thought he was entitled to receive. Petitioner contested both its obligation to repurchase and the amounts asked for by Steinbugler. **Title to the stock was involved only incidentally.** The fact that petitioner was the loser in this litigation and was forced to acquire the stock against its will and pay the judgment which Steinbugler obtained against it, does not, in our opinion, impair its right to deduct the litigation expenses of that suit. We hold that the amounts expended by petitioner in 1942 for legal fees and litigation expenses, all in connection with the Steinbugler litigation, are deductible in 1942 under Section 23 (a) (1) (A), supra. Cf. **Kornhauser v. United States**, 276 U. S. 145; **Welch v. Helvering**, 290 U. S. 111."

Similarly, in the case now before this Court, the majority shareholders (Taxpayers) in the state court litiga-

tion were not endeavoring to acquire the title to the stock of the dissenting shareholder—they already had a statutory obligation to purchase such stock—nor were they defending the title to stock they already owned. On the contrary, in the state court action the majority shareholders were strenuously attempting to keep their liability to a minimum. The very essence of the litigation was the dissenting shareholder's effort to obtain the highest possible value under the Iowa appraisal statute for her shares. The majority shareholders (Taxpayers) resisted and endeavored to hold the amount of the value of the shares to a minimum. Title to the stock was never involved, not even incidentally.

In **Straub v. Granger**, 143 F. Supp. 250 (D. C. Pa. 1956), the Court stated, at page 252, the issue for determination as follows; to-wit:

> ". . . whether amounts expended by taxpayers as attorneys fees are deductible under Section 23 (a) (2) of the Internal Revenue Code of 1939 as amended, 26 U. S. C. A., as ordinary and necessary expenses for the management, conservation or maintenance of income-producing property . . ."

The Court's holdings appear on pages 253 and 254 as follows, to-wit:

> "16. **The main and primary purpose of taxpayers in obtaining legal advice was to protect their existing investment** in the Fort Pitt Bridge Works.
>
> 17. **Expenditures of taxpayers for the legal services in controversy were not made for the purpose of acquiring stock** but were ordinary and necessary expenses incurred in the management, conservation or maintenance of income-producing property."

Likewise, in the case at bar, the main and primary purpose of the majority shareholders (Taxpayers) in ob-

taining legal advise and in commencing the state court litigation out of which the expenses in question arose was to conserve, maintain and protect investment properties which they held for the production of income. To effectuate this purpose the majority shareholders made every effort to minimize the value placed upon the dissenting shareholder's stock in the state court litigation. The acquisition of the title to the common stock of the Telegraph-Herald owned by the dissenting shareholder was never involved, not even remotely. The legal obligation imposed upon the majority shareholders (Taxpayers) to acquire or to purchase such stock arose at the special meeting of the common stock shareholders of the Telegraph-Herald on June 9, 1960 (A. 9).

The Court's rationale for its determination in the **Straub v. Granger** case is stated as follows on pages 254 and 255 of 143 F. Supp.; to-wit:

> "The Court thinks the weight of the arguments is in plaintiff's favor. There are two difficulties with defendant's position. **First of all, it confuses the nature of taxpayers' original request of counsel with the form of the advice which was given.** The question of acquiring stock control, or perfecting title to the stock, did not originate with the Straubs but came into being only after they were told by counsel they could maintain their position in the company in that manner. It can not be doubted that the subsequent dealings of James M. Straub with counsel contributed to the end result of taxpayers' obtaining additional shares of stock, **but nevertheless, title to the stock eventually acquired was not perfected by their expenditures for legal services.** On the whole, the court is satisfied that such subsequent conferences and legal services are regarded properly in relation to the purpose for which taxpayers obtained counsel rather than to the increased ownership which resulted. **What**

was involved essentially was the rendition of advice as to a method in which they could protect their investment in the company and as to the manner in which that could be done. Cf. Bagley v. Commissioner, 1947, 8 T. C. 130, 132-133.

Secondly, the cases have established a well-defined exception to the rules defendant contends for, which depends upon a determination, where questions of defending or perfecting title to property may be involved, of what the main and primary purpose of the taxpayer has been in incurring the legal, or other, expenses in issue . . . (Citations omitted). . . . Courts have been cautioned that, in tax matters, the form of a transaction is not to prevail over its substance. **Urquhart v. Commissioner,** supra, 215 F. 2d at page 19. **Accordingly, the fact that taxpayers' ownership in the corporation was increased partly through the services of counsel does not establish that counsel was paid for acquiring stock. If counsel was retained in the manner in which he was because the Straubs feared their investment was unsafe in the control of the existing management, payment to counsel was not part of the cost of property acquired."**

It is respectfully submitted that a perusal of the facts herein and an application of the "primary purpose test" thereto makes the conclusions reached by Judge Bruce in his dissenting opinion inevitable (A. 42); to-wit:

"The case of **Woodward v. Quigley,** supra, was brought to resolve such a purely private right between the majority and dissenting stockholders. The corporation was not a party thereto and the action did not involve its business operations. The stock which petitioners owned in Telegraph-Herald was held by them for investment purposes and the extension of the life of the corporation was necessary to the management, conservation, or maintenance of such property. The majority stockholders

recognized their obligation under the Iowa statute to purchase the stock of the dissenting stockholder. The majority stockholders were interested in minimizing the value of the stock whereas the dissenting stockholder was interested in a high valuation. Being unable to agree upon the "real value" of the stock in question, the primary, and, in fact, the only purpose of the litigation was to obtain a court determination of the real value of the stock. Neither a money judgment nor the enforcement of a contract or statutory obligation was sought or determined. Title to the stock was never in question, and was only incidentally involved." (Footnotes omitted.)

CONCLUSION

For the reasons stated it is requested that the Supreme Court of the United States grant the following relief; to-wit:

(a). That the judgment of the Court of Appeals be reversed and a determination made that the Taxpayers are not deficient in their income tax payments for the taxable year 1963; and,

(b). That the Taxpayers, Fred W. Woodward and Elsie M. Woodward, are entitled to a refund for overpayment of their 1963 income tax in the amount of $1,134.47 or such other amount plus interest which is legally refundable (A. 8).

Respectfully submitted

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STATUTES, REGULATIONS AND LEGISLATIVE HISTORY.

STATUTES.

Internal Revenue Code of 1939

"Sec. 23. Deductions from Gross Income.

In computing net income there shall be allowed as deductions:

(a) Expenses.—

(1) Trade or business expenses.—

(A) In general.—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity. In the case of any sports program conducted for the benefit of the American National Red Cross, expenses described in section 22 (b) (16) (B) shall be allowable under this subparagraph only to the extent that such expenses exceed the amount ex-

cluded from gross income by section 22 (b) (16)."

* * * * * * * *

Note: Sec. 23(a)(1)(A) of 1939 IRC is comparable to Sec. 162(a) of 1954 IRC.

Internal Revenue Code of 1939

"Sec. 23 Deductions from Gross Income.

In computing net income there shall be allowed as deductions:

(a) Expenses.—

* * * * * * * *

(2) Non-trade or non-business expenses.—In the case of an individual, all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income."

* * * * * * * *

Note: Sec. 23(a)(2) of 1939 IRC is comparable to Sec. 212 of 1954 IRC.

Internal Revenue Code of 1939

"Sec. 24. Items Not Deductible.

(a) General Rule.—In computing net income no deduction shall in any case be allowed in respect of—

(2) Any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate, except expenditures for the development of mines or deposits deductible under section 23(cc); . . ."

* * * * * * * *

Note: Sec. 24(a)(2) of 1939 IRC is comparable to Sec. 263(a)(1) and (2) of 1954 IRC.

Internal Revenue Code of 1954

"Sec. 162. Trade or Business Expenses.

(a) In General.—There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including—

(1) a reasonable allowance for salaries or other compensation for personal services actually rendered;

(2) traveling expenses (including amounts expended for meals and lodging other than amounts which are lavish or extravagant under the circumstances) while away from home in the pursuit of a trade or business; and

(3) rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity."

* * * * * * * *

Note: Sec. 162(a) of 1954 IRC is comparable to Sec. 23(a)(1)(A) of 1939 IRC.

Internal Revenue Code of 1954.

"Sec. 212. Expenses for Production of Income.

In the case of an individual, there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year—

(1) for the production or collection of income;

(2) for the management, conservation, or maintenance of property held for the production of income; or

(3) in connection with the determination, collection, or refund of any tax."

Note: Sec. 212 of 1954 IRC is camparable to Sec. 23(a)(2) of 1939 IRC.

Internal Revenue Code of 1954.

"Sec. 263. Capital Expenditures.

(a) General Rule.—No deduction shall be allowed for—

(1) Any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate. This paragraph shall not apply to—

(A) expenditures for the development of mines or deposits deductible under section 616,

(B) research and experimental expenditures deductible under section 174,

(C) soil and water conservation expenditures deductible under section 175,

(D) expenditures by farmers for fertilizer, etc., deductible under section 180, or

(E) expenditures by farmers for clearing land deductible under section 182.

(2) Any amount expended in restoring property or in making good the exhaustion thereof for which an allowance is or has been made."

• • • • • • • •

Note: Sec. 263(a)(1) and (2) of 1954 IRC are comparable to Sec. 24(a) of 1939 IRC.

REGULATIONS.

Promulgated Pursuant to IRC of 1939.

"Sec. 39.24(a)-2 Capital Expenditures.

(a) Expenditures except non-depreciable mine development expenditures. Amounts paid for increasing the capital value or for making good the depreciation (for which a deduction has been made) of property are not deductible from gross income. See section 23(1). Amounts expended for securing a copyright and plates, which remain the property of the person making the payments, are investments of capital. The cost of defending or perfecting title to property constitutes a part of the cost of the property and is not a deductible expense. The amount expended for architects' services is part of the cost of the building. Commissions paid in purchasing securities are a part of the cost price of such securities. Commissions paid in selling securities are an offset against the selling price, except that in the case of dealers in securities such commissions may be treated as an ordinary and necessary business expense. Amounts to be assessed and paid under an agreement between bondholders or shareholders of a corporation to be used in a reorganization of the corporation, are investments of capital and not deductible for any purpose in returns of income. See Sec. 39.22(a)-16. An assesment paid by a shareholder of a national bank on account of his statutory liability is ordinarily not deductible but, subject to the provisions of the Internal Revenue Code, may in certain cases represent a loss. Expenses of the organization of a corporation, such as incorporation fees, attorneys' and accountants' charges, are capital expenditures and not deductible from gross income. A holding company which guarantees dividends at

a specified rate on the stock of a subsidiary corporation for the purpose of securing new capital for the subsidiary and increasing the value of its stock holdings in the subsidiary may not deduct amounts paid in carrying out this guaranty in computing its net income, but such payments may be added to the cost of its stock in the subsidiary."

• • • • • • • •

Promulgated Pursuant to IRC of 1954.

"Sec. 1.162-1 Business Expenses.

(a) In general. Business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business, except items which are used as the basis for a deduction or a credit under provisions of law other than section 162."

• • • • • • • •

"Sec. 1.212-1. Non-Trade or Non-Business Expenses.

(a) *An expense may be deducted under section 212 only if—*

(1) *It has been paid or incurred by the Taxpayer during the taxable year* (i) for the production or collection of income which, if and when realized, will be required to be included in income for Federal income tax purposes, or (ii) *for the management, conservation, or maintenance of property held for the production of such income,* or (iii) in connection with the determination, collection, or refund of any tax; and

(2) *It is an ordinary and necessary expense for any of the purposes stated in subparagraph (1) of this paragraph.*

(b) *The term 'income' for the purpose of section 212 includes not merely income of the taxable year but also income which the taxpayer has realized in a prior taxable year or may realize in subsequent taxable years; and is not confined to recurring income but applies as well to gains from the disposition of property.* For example, if defaulted bonds, the interest from which if received would be includible in income, are purchased with the expectation of realizing capital gain on their resale, even though no current yield thereon is anticipated, ordinary and necessary expenses thereafter paid or incurred in connection with such bonds are deductible. Similarly, ordinary and necessaary expenses paid or incurred in the management, conservation, or maintenance of a building devoted to rental purposes are deductible notwithstanding that there is actually no income therefrom in the taxable year, and regardless of the manner in which or the purpose for which the property in question was acquired. *Expenses paid or incurred in managing, conserving, or maintaining property held for investment may be deductible under section 212 even though the property is not currently productive and there is no likelihood that the property will be sold at a profit or will otherwise be productive of income and even though the property is held merely to minimize a loss with respect thereto.*

* * * * * * * *

(d) *Expenses, to be deductible under section 212, must be 'ordinary and necessary'. Thus, such expenses must be reasonable in amount and must bear a reasonable and proximate relation to the production or collection of taxable income or to the management, conservation, or maintenance of property held for the production of income.*

(e) A deduction under section 212 is subject to the restrictions and limitations in part IX (section 261 and following), subchapter B, chapter 1 of the Code, relating to items not deductible. Thus, no deduction is allowable under section 212 for any amount allocable to the production or collection of one or more classes of income which are not includible in gross income, or for any amount allocable to the management, conservation, or maintenance of property held for the production of income which is not included in gross income. See section 265. Nor does section 212 allow the deduction of any expenses which are disallowed by any of the provisions of subtitle A of the Code, even though such expenses may be paid or incurred for one of the purposes specified in section 212.

(k) Expenses paid or incurred in defending or perfecting title to property, in recovering property (other than investment property included in gross income), or in developing or improving property, constitute a part of the cost of the property and are not deductible expenses. Attorneys' fees paid in a suit to quiet title to lands are not deductible; but if the suit is also to collect accrued rents thereon, that portion of such fees is deductible which is properly allocable to the services rendered in collecting such rents. Expenses paid or incurred in protecting or asserting one's right to property of a decedent as heir or legatee, or as beneficiary under a testamentary trust, are not deductible.

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(m) An expense (not otherwise deductible) paid or incurred by an individual in determining or contesting a liability asserted against him does not become deductible by reason of the fact

that property held by him for the production of income may be required to be used or sold for the purpose of satisfying such liability.

(n) Capital expenditures are not allowable as non-trade or non-business expenses. The deduction of an item otherwise allowable under section 212 will not be disallowed simply because the taxpayer was entitled under subtitle A of the Code to treat such item as a capital expenditure, rather than to deduct it as an expense. For example, see section 266. Where, however, the item may properly be treated only as a capital expenditure or where it was properly so treated under an option granted in subtitle A of the Code, no deduction is allowable under section 212; and this is true regardless of whether any basis adjustment is allowed under any other provision of the Code."

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"Sec. 1.263 (a)-2 Examples of Capital Expenditures.

The following paragraphs of this section include examples of capital expenditures:

(a) The cost of acquisition, construction, or erection of buildings, machinery and equipment, furniture and fixtures, and similar property having a useful life substantially beyond the taxable year."

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"(c) The cost of defending or perfecting title to property."

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"(e) Commissions paid in purchasing securities. Commissions paid in selling securities are an offset against the selling price, except that in the case of dealers in securities such commissions

may be treated as an ordinary and necessary business expense."

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LEGISLATIVE HISTORY.

Revenue Act of 1942: HOUSE REPORT No. 2333, 77th Congress, 2nd Session (1942); 1942-2 C.B. 372.

At page 410 of 1942-2 C.B.:

"6. Nontrade or Nonbusiness Deductions.

The existing law allows taxpayers to deduct expenses incurred in connection with a trade or business. Due partly to the inadequacy of the statute and partly to court decisions, nontrade or nonbusiness expenses are not deductible, although nontrade or nonbusiness income is fully subject to tax. The bill corrects this inequity by allowing all of the ordinary and necessary expenses paid or incurred for the production or collection of income or for the management, conservation, or maintenance of property held for the production of income. Thus, whether or not the expense is in connection with the taxpayer's trade or business, if it is expended in the pursuit of income or in connection with property held for the production of income, it is allowable."

At pages 429 and 430 of 1942-2 C.B.:

"Section 118. Nontrade or Nonbusiness Deductions.

This amendment allows a deduction for the ordinary and necessary expenses of an individual paid or incurred during the taxable year for the production and collection of income, or for the management, conservation, or maintenance of property held by the taxpayer for the production of income, whether or not such expenses are paid or

incurred in carrying on a trade or business, and also allows a deduction for the exhaustion and wear and tear (including a reasonable amount for obsolescence) on property held for the production of income, whether or not such property is used by the taxpayer in a trade or business.

For an expense to be deductible under this section, it must have been incurred either (1) for the production or collection of income, or (2) for the management, conservation, or maintenance of property held for the production of income. *Ordinary and necessary expenses so paid or incurred are deductible under section 23(a)(2) even though they are not paid or incurred for the production or collection of income of the taxable year or for the management, conservation, or maintenance of property held for the production of such income. The term 'income' for this purpose comprehends not merely income of the taxable year but also income which the taxpayer has realized in a prior taxable year or may realize in subsequent taxable years, and is not confined to recurring income but applies as well to gain from the disposition of property. Expenses incurred in managing or conserving property held for investment may be deductible under this provision even though there is no likelihood that the property will be sold at a profit or will otherwise be productive of income.* The expenses, however, of carrying on a transaction which does not constitute a trade or business of the taxpayer and is not carried on for the production of income or for the management, conservation, or maintenance of property, but which is carried on primarily as a sport, hobby, or recreation are not allowable as nontrade or nonbusiness expenses.

Expenses, to be deductible under section 23(a)(2) must be ordinary and necessary, which rule presupposes that they must be reasonable in amount and must bear a reasonable and proximate relation to the production or collec-

tion of income, or to the management, conservation, or maintenance of property held for that purpose.

A deduction under this section is subject, except for the requirement of being incurred in connection with a trade or business, to all the restrictions and limitations that apply in the case of the deduction under section 23(a)(1)(A) of an expense paid or incurred in carrying on any trade or business. Section 24(a)(5), as amended by this section, while continuing to disallow any amount allowable as a deduction, whether under section 23(a)(2) or otherwise, which is allowable to one or more cases of tax-exempt income, other than interest, has the effect in addition of disallowing a deduction under section 23(a)(2) for amounts allowable under that section which are allocable to tax-exempt interest.

Expenses incurred by an administrator or executor in the administration of the estate of a decedent, such, for example, as expenses in securing the processes and orders of the court having jurisdiction over the probate of an estate, or in adjusting claims against the estate, or in distributing the remaining assets to the beneficiaries, are not deductible under this section. Ordinary and necessary expenses, however, which are paid or incurred during the taxable year by an administrator or an executor for the production or collection of income which must be reported by the estate for income tax purposes, may be claimed as deductions under this section notwithstanding that deductions therefor are allowable under section 812(b) in computing the gross estate subject to the estate tax. Accordingly, subsection (c) of this section amends section 162 to provide that no deduction shall be allowed under section 23(a)(2) in computing the net income of the estate for amounts for which there may have been or has already been allowed a deduction under section 812(b) in computing the net estate of the decedent. The present amendment would not allow as a deduction under section

23(a)(2) for income tax purposes any amount which is allowable under section 812(b) as a deduction in computing the net estate of a decedent for estate tax purposes, unless the Commissioner receives a statement, filed within the time and in the manner and form prescribed by him, to the effect that the amount in question has not been claimed or allowed as a deduction under section 812(b) and that the right to have such items allowed at any time as a deduction under section 812(b) is waived.

Subsection (d) of this section amends 23(1) of the Internal Revenue Code so as to allow, in addition to the deduction allowable under the existing law, a deduction for the exhaustion, wear and tear of property held by the taxpayer for the production of income, whether or not the property in question is used in the trade or business of the taxpayer, including a reasonable allowance for obsolescence. Except for this, the new allowance is subject to the same limitations and restrictions which have been applicable under this section prior to the present amendment.

The amendments made to the Internal Revenue Code by this section are applicable to all taxable years beginning after December 31, 1938. These amendments shall also be effective as if they were a part of the Revenue Act of 1938 or any prior Revenue Act on the date of its enactment."

Revenue Act of 1942: SENATE REPORT No. 1631, 77th Congress, 2nd Session (1942); 1942-2 C.B. 504.

At page 570 of 1942-2 C.B.:

"Section 121. Non-Trade or Non-Business Deductions.

This section is the same as section 118 of the House bill, except that subsection (c) of that section has been omitted therefrom and now appears as section 163 and a clerical amendment has been made in subsection (b). The amend-

ment made by this section allows a deduction for the ordinary and necessary expenses of an individual paid or incurred during the taxable year for the production and collection of income, or for the management, conservation, or maintenance of property held by the taxpayer for the production of income, whether or not such expenses are paid or incurred in carrying on a trade or business, and also allows a deduction for the exhaustion and wear and tear (including a reasonable amount for obsolescence) on property held for the production of income, whether or not such property is used by the taxpayer in a trade or business.

For an expense to be deductible under this section, it must have been incurred either (1) for the production or collection of income, or (2) *for the management, conservation, or maintenance of property held for the production of income. Ordinary and necessary expenses so paid or incurred are deductible under section 23(a)(2) even though they are not paid or incurred for the production or collection of income of the taxable year or for the management, conservation, or maintenance of property held for the production of such income. The term 'income' for this purpose comprehends not merely income of the taxable year but also income which the taxpayer has realized in a prior taxable year or may realize in subsequent taxable years, and is not confined to recurring income but applies as well to gain from the disposition of property.* Expenses incurred in managing or conserving property held for investment may be deductible under this provision even though there is no likelihood that the property will be sold at a profit or will otherwise be productive of income, and even though the property is held merely to minimize a loss with respect thereto. The expenses, however, of carrying on a transaction which does not constitute a trade or business of the taxpayer and is not carried on for the production of income or for the management, conservation, or maintenance of property, but which is carried on primarily

as a sport, hobby, or recreation are not allowable as non-trade or non-business expenses.

Expenses, to be deductible under section 23(a)(2), must be ordinary and necessary, which rule presupposes that they must be reasonable in amount and must bear a reasonable and proximate relation to the production or collection of income, or to the management, conservation, or maintenance of property held for that purpose.

A deduction under this section is subject, except for the requirement of being incurred in connection with a trade or business, to all the restrictions and limitations that apply in the case of the deduction under section 23 (a)(1)(A) of an expense paid or incurred in carrying on any trade or business. Section 24(a)(5), as amended by this section, while continuing to disallow any amount allowable as a deduction, whether under section 23(a)(2) or otherwise, which is allocable to one or more classes of tax-exempt income, other than interest, has the effect in addition of disallowing a deduction under section 23(a)(2) for amounts allowable under that section which are allocable to tax-exempt interest.

Subsection (c) of this section amends section 23(l) of the Code so as to allow, in addition to the deduction allowable under the existing law, a deduction for the exhaustion, wear, and tear of property held by the taxpayer for the production of income, whether or not the property in question is used in the trade or business of the taxpayer, including a reasonable allowance for obsolescence. Except for this, the new allowance is subject to the same limitations and restrictions which have been applicable under this section prior to the present amendment.

The amendments made to the Code by this section are applicable to all taxable years beginning after December 31, 1938. These amendments shall also be effective as if they were a part of the Revenue Act of 1938 or any prior Revenue Act on the date of its enactment."